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SUBJECT: China/Economic Plans: Continued Reform Endorsed

REF: A) Beijing 592, B) Beijing 1571, C) Beijing 1556, D) Beijing 39, E) Beijing 665 and previous, F) Beijing 693, Beijing 829, Hong Kong 421 G) Beijing 422, Beijing 359

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¶1. (SBU) SUMMARY. Beijing's 2009 economic planning document, in contrast to last year's version and some of the trends evident in China's recent economic support and stimulus plans, endorses liberalization and economic transformation. Financial reform continues. China's largest state-owned enterprises (SOEs)--and in particular the giant services monopolies--are singled out for increased private investment and competition, while financial and logistical support is offered to smaller private companies. The document calls for further progress in ending energy price manipulation that encourages energy inefficiency, as well as provision of social services and SOE profit-sharing to spur domestic consumption. The plan shows little support for exports, although outward bound investment is encouraged. The plan settles for merely re-stating past commitments on rural reform and backtracks slightly in the area of exchange rate flexibility; with millions of migrants returning home to their land and falling exports, there seems to be little appetite for major new steps in these areas. China's current economic support policies certainly emphasize industrial and infrastructure investment and consolidation; the State Council, however, has indicated in this annual planning document that (at least in theory) China's future lies with increased marketization and liberalization. END SUMMARY.

¶2. (SBU) China has released its 2009 economic plan, the "Opinions Regarding the Work on Deepening Systemic Economic Reforms in 2009."

The annual plan, issued by China's State Council and coordinated by the National Development and Reform Commission (NDRC), is designed to set the overall economic direction for the coming year.

In all, it lays out more than seventy specific policy tasks, and for each one names the ministry (or ministries) responsible for implementation. NDRC is tasked with providing overall interagency coordination and reporting to the State Council on progress. The full translated text of the document is posted on the Embassy Economic Section website at http://www.intelink.gov/communities/state/chi naecon/.

Continuing Reform

¶3. (SBU) The 2009 plan is a clear endorsement of continued

economic liberalization and marketization. In the first paragraph the plan asserts that, in spite of the economic down turn, China cannot diverge from continuing opening and reform. Its stated goals are consistent with fundamental economic transformation, including increasing domestic demand and improving livelihoods. Although government regulation is welcomed, the endorsed mechanism is the market, which should be perfected as opposed to managed.

Government as Regulator, Not Manipulator or Primary Investor

¶4. (SBU) Tracking with this endorsement of market primacy, the plan calls for further adjustment of the role of the government in the economy. Specifically, it calls for the government to adopt a supervisory role. Investments subject to government approval are to be reduced and approvals decentralized. The plan has completely new language calling for caution in government-led investment, to ensure that it attracts, as opposed to crowds out, private investment. Even government-led programs to foster indigenous innovation, a mainstay of many of China's recent industrial revitalization plans (REF E), must be "market oriented" with "enterprises at the core."

Cracking Open the Monopolies, Transforming the Economy

¶5. (SBU) Continuing with the theme of valuing private investment, the plan opens the door to private investment in many of China's largest state-dominated services monopolies, specifically mentioning petroleum, railroads, electricity, telecom, and municipal services. Private sector investment in services SOEs is welcomed, with promises to open the services sector to greater

market access. The long-awaited establishment of a security review mechanism for foreign mergers and acquisitions is to be speeded up (REF D for background of security review). Services are also emphasized in the context of trade, with the plan calling for a new regulatory framework for trade in services and creation of an outsourcing industry.

¶6. (SBU) The plan, as in previous years, calls for further reform of China's controlled pricing for grains and energy. What is different this year is the reason stated: prices must be marketized and liberalized in order to transform China's economic growth model. Singled out for particular focus are electricity and water prices that subsidize industrial users at the expense of services and retail consumers. Similarly, the plan endorses the various healthcare, wage, unemployment insurance, housing, and pension reforms introduced in the past few months, but with the rationale that these reforms are important to spur consumption (REF F).

Small (and Medium-sized) is Beautiful

¶7. (SBU) Despite government lending and stimulus projects that benefit China's largest enterprises and revitalization plans that aim at industry wide consolidation (REF E), the 2009 plan focuses on small and medium sized enterprises. SOEs are mentioned as institutions in need of reform, while SMEs will receive credit guarantees and other new financing facilities. Start-ups are welcomed as a means to increase employment opportunities, and small- and medium-sized financial enterprises will be promoted.

¶8. (SBU) In the section on improving the people's livelihood, the plan calls for regulating SOE managers' salaries in order to keep income disparity within reasonable limits. A somewhat cryptic clause in the section on taxes appears aimed at going after SOE excess profits and operating budgets, which have come under great criticism this year for taking money out of the pockets of consumers and using it for over-investment. The section calls for returns to "state-owned capital" to go into a social security budget.

Financial Reform Continues

¶9. (SBU) Financial sector reform is extensively addressed in the plan; there is little evidence of back-tracking many observers speculated could result from the global financial crisis. Continued reform of banks, private asset management companies, rural credit, deposit insurance, interest rates, and equity and bond markets are all endorsed. Pushing forward, the plan adds requirements for reform of the insurance industry and development of private equity funds.

Exports not Emphasized, but Outward Investment Is

¶10. (SBU) Despite a serious downturn in China's exports, there is no evidence in the plan of an attempt to prop up exports. A concern with potential trade protectionism is apparent in the endorsement of a "mechanism to deal with trade frictions" and calls to pursue Free Trade Agreements (FTAs). Imports are dealt with only in the context of management of advanced technology and strategic inputs, although there is also mention of an "early warning system" to inform Beijing of surges in imports, exports, or investment in certain sectors. Outbound investment gets a boost through regulatory liberalization and financial and logistical support for enterprises to "go-out" and use foreign earnings to invest overseas (REF A Chinalco cable).

Rural and ForEx Reform Not/Not Evident

¶11. (SBU) The plan calls for rural reform and development, but the specific programs mentioned as well as the wording used is consistent with past years, indicating little appetite for breaking new ground (REF G).

¶12. (SBU) While the plan, as in previous years, calls for an improved RMB exchange regime, it notably drops language in previous plans calling for increased foreign exchange flexibility.

As Vice Premier Wang Qishan recently told Treasury Secretary Geithner (REF B), China intends to maintain a stable yuan exchange

rate until the international economic situation stabilizes.

Comment

¶13. (SBU) Many of China's programs and policies over the last year have raised concerns that the government might be backtracking on opening and reform (REF C). China's recent fiscal and monetary stimulus packages have funneled resources to and through China's state sector. Further, the fruits of the stimulus' resources have accrued disproportionately to traditional large, industrial companies, most of which are SOEs. The accompanying industry revitalization plans have almost without exception emphasized industry consolidation and government support over structural economic reform. To be fair, these measures should be seen as rapid and decisive responses to the global financial crisis, but they reinforced other preferential policies aimed at strengthening central government-owned SOEs that pre-dated the outbreak of the crisis.

¶14. (SBU) The themes echoing throughout the "Opinions Regarding the Work on Deepening Systemic Economic Reforms in 2009" stand in stark contrast to these statist trends. The State Council, through this document, largely has endorsed a vision of a smaller, less controlling government. China's leadership has apparently accepted the view of many Chinese economists that the state-owned monopolies, particularly the large service monopolies, are preventing fundamental structural reform. Likewise, the plan addresses other standard liberal-economists' complains, such as the lack of a social safety net and inefficient financial markets leading to excess savings and poor allocation of capital, respectively.

¶15. (SBU) China's current policies, aimed to support short-term economic growth and thus social stability, may in practical terms set back overall economic restructuring. The State Council, however, has indicated in this annual planning document that the general trend should be towards increased marketization and liberalization.

¶16. (SBU) We strongly recommend that USG agencies engaging with Chinese counterparts on any of the issues covered in the plan reference its relevant sections. It is likely that U.S. arguments for further liberalization of the Chinese economy would be strengthened by citing, where appropriate, this State Council guidance.

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